

TEACHERS' RETIRMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: General – Request for Proposal
for Master Custodian

ITEM NUMBER: 7

ATTACHMENT(S): 3

ACTION: X

DATE OF MEETING: January 5, 2000

Ms. Okada/

INFORMATION: _____

PRESENTER(S): Mr. Petzold

BACKGROUND

The current master custodian for the California State Teachers' Retirement System (CalSTRS) is State Street Bank and Trust Company (SSB). Some of the services provided by SSB are safekeeping, recordkeeping/accounting, securities clearance, and performance measurements. SSB's contract will expire on April 30, 2000. In all likelihood we will need to extend the contract to accommodate the timeline for the selection process.

The first Request for Proposal (RFP) for Master Custody Services was released in 1986 with a subsequent RFP issued in 1992. SSB was selected for both processes. In late 1996 staff requested and the Investment Committee approved a contract extension to April 30, 2000.

One of the objectives approved by the Investment Committee for the 1999-2000 fiscal year is to issue and release a RFP for master custody services. The structure of this RFP will incorporate the processes followed in recent RFPs. These include open ended contracts (evergreen) and delegation of selection to staff.

Attachment 1 provides detailed information for the RFP that includes:

- ⇒ Time line for the RFP
- ⇒ Introduction
- ⇒ Purpose of the RFP
- ⇒ Services to be Provided
- ⇒ Minimum Qualifications
- ⇒ Fee Structure
- ⇒ Proposal Evaluation Criteria

Staff is proposing that the contract participation goal requirement for Disabled Veterans Business Enterprise be required after the final selection process is completed. Upon

submission of proposals to CalSTRS, all proposers shall execute a certification, included as Attachment 2, confirming their intent to submit the necessary documentation to CalSTRS in the event they are selected. The selected firm shall be required to submit documentation substantiating compliance with the goal prior to the final execution of the contract.

RECOMMENDATION

In concert with the previous RFPs, staff recommends that the Investment Committee approve the following by adopting the attached proposed Resolution (Attachment 3):

1. Extension of current contract, to accommodate the timeline for the RFP process;
2. Release of the Request for Proposal as described in Attachment 2;
3. Use of open ended contracts (Evergreen contracts), and ;
4. Delegation of the "Final Selection" to staff periodic updates to the Investment Committee.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
MASTER CUSTODY SERVICES

TIME SCHEDULE:

Date of Issue:	<u>February 2000</u>
Deadline for Submission of Written Questions:	<u>February 2000</u>
Final Filing Date:	<u>April 2000 @ 4:30 p.m.</u>
Pre-evaluation Screening:	<u>April, 2000</u>
Proposal Evaluation:	<u>April/May 2000</u>
Finalist Interviews:	<u>June 2000</u>
Submission of Contract Partici- pation Goal Documentation:	<u>To be Announced</u>
Reference Checks:	<u>To be Announced</u>
On-Site (Optional):	<u>To be Announced</u>
Post Notice of Intent to Award:	<u>Immediately After Selection</u>
Award of Contract:	<u>5 business days after posting notice of intent to award</u>

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
REQUEST FOR PROPOSAL

MASTER CUSTODY SERVICES
CONTRACT NO.

I. INTRODUCTION

The California State Teachers' Retirement System (CalSTRS) administers an investment portfolio with approximately \$105 billion in assets. As of November 30, 1999, the assets were invested as follows: \$45.5 billion in domestic equities; \$27.4 billion in international equities; \$24.6 billion in domestic fixed income securities; \$2.8 billion in real estate equity; \$3.4 billion in alternative investments; and \$1.2 billion in cash reserves.

Legislation effective in 1987 authorized the Teachers' Retirement Board (Board) to retain a bank or trust company to serve as custodian for safekeeping and delivery of CalSTRS' assets, as well as securities valuation, investment performance reporting, and other services in connection with the investments of the Teachers' Retirement Fund (Fund). This Request for Proposal seeks a bank or trust company to provide these specified custody services and meet the challenge of our demands within the framework of California's statutory responsibilities. The current contract for these services expire in the Year 2000.

CalSTRS intends to contract with one firm to provide master custody services for both domestic and international assets.

II. PURPOSE

The purpose of this Request for Proposal (RFP) is to solicit from qualified institutions, proposals to provide comprehensive custody and recordkeeping services to CalSTRS. Broadly speaking, these services include: custody over securities; settlement of purchases and sales of securities; identification and collection of income which are due and payable on assets held; providing a management information/accounting system; providing performance and analytics; information retrieval services and other associated services as defined in Section IV, Services to be Provided.

III. DESCRIPTION OF EXISTING CUSTODY OPERATIONS

The following descriptions of CalSTRS' existing custody operations are provided as additional information and will be necessary for future custody operations.

A. Claims (Disbursements) and Remittance Process

California State Law mandates that all disbursements be submitted for approval to the State Controller's Office (SCO) on a daily basis in the form of a Claim Schedule.

Upon approval, a warrant is issued and forwarded to the State Treasurer's Office (STO) for wiring of funds to the Custodian Bank. Likewise all remittances are wired to the STO who in turn reports the amounts to the SCO for accounting purposes.

Currently a process is in place that complies with state law. The following are the participants in the process.

1. Custodian - Generates information necessary to identify total disbursements, i.e. purchases, etc., for the day. Identifies and wires total receipts, i.e. sale proceeds, income, etc., for the day (no netting).
2. CalSTRS - Receives information from the Custodian and processes claim schedules for delivery to the SCO by 9:00 a.m. Pacific Time. Receives detail on the total remittances and forwards information to the SCO and STO for preparation of the remittance advice.
3. State Controller's Office - Verifies numeric accuracy of disbursement information. Upon approval issues and delivers warrant to the STO. Validates receipts and appends amount to fund balance.
4. State Treasurer's Office - Receives warrant from the SCO and wires amount to Custodian Bank. Receives wire from Custodian Bank for remittances and notifies the SCO.

B. Investment Managers

CalSTRS utilizes internal and external investment managers. The investment managers are the originators of the transactions by determining what to buy or sell, giving trade orders to security dealers. This information is transmitted daily to the custodian who then settles the trade as contracted.

C. State Controller's Office (SCO)

The SCO's statutory and constitutional responsibilities consist of three functional areas:

1. Accounting Function - SCO is charged with accounting for all expenditures made and revenues received by the State. In accordance with this responsibility, the SCO's Division of Accounting reviews all requests for disbursements to determine that sufficient funds are available and maintains a record of cash and appropriation balances.
2. Internal Control Function - SCO provides an internal control function by controlling all disbursements. Article XVI, Section 7 of the California State Constitution requires that "Money may be drawn from the Treasury only

through an appropriation made by law and upon a SCO's duly drawn warrant". Additionally, Government Code Section 20202 requires all payments from the retirement fund shall be made on SCO's warrants. The SCO, Division of Audits is required to pre-audit all claims for disbursements to insure that the payment is legal and that funds are available prior to drawing a warrant. SCO also provides post-audits of receipts made to the treasury.

For all retirement fund transactions, the pre-audit activities include a confirmation of the availability of funds, review of the transaction authorization, check of any computations and dates, and a review of the transaction's account coding to insure proper accounting of the transaction.

3. Oversight Function - The SCO performs an oversight function on the operation and management of all public retirement funds in California. The oversight function is defined in the Government Code. In addition to these specific oversight activities, SCO conducts audits of CalSTRS as are necessary to assure the propriety of the administration of public retirement funds.

D. State Treasurer's Office (STO)

The STO is responsible for wiring sufficient funds to the Custodian Bank for daily settlement of securities upon receipt of a warrant from the SCO. Also, the STO receives daily funds for the CalSTRS account from the Custodian Bank for all investment income, sale proceeds, etc.

E. Securities Lending Program

Currently CalSTRS contracts with multiple entities to provide securities lending services for various portions of the portfolio.

All loaned securities, plus accrued interest, are fully collateralized. It is the responsibility of the lending institution to credit all income (dividends, interest and other distributions) to the CalSTRS account at the custodian bank on the scheduled payable date. Detail reports from the securities lending custodian are to be made available to CalSTRS electronically via email or access to their system. These reports are to include the daily lending activity and income earned. Summary reports are also provided by the custodian to CalSTRS containing average volume of securities loaned and total income received.

F. Real Estate Cash Management System

The CalSTRS real estate portfolio consists of various property types. These include projects such as industrial parks, office buildings, shopping malls and apartments.

The current cash management system utilizes multiple banks for controlled disbursements and lock box collections. All collections from the lock boxes and reimbursement of the controlled disbursement account flows through the Custodian Bank as would any other normal investment receipt or disbursement.

G. Foreign Exchange (FX)

At this time the State Controller's Office (SCO) prohibits FX transactions directly between two foreign currencies. All FX transactions must occur between a foreign currency and the U.S. dollar. In addition, it is prohibited to purchase currency in anticipation of future trading activity. All foreign currency purchases must equal the net settlement amount of a purchase or group of purchases.

The netting of proceeds from sales and/or income receipts with the funds required for purchases, and entering into an FX contract for the difference, is prohibited. FX transactions to invest the proceeds from sales and income receipts must be conducted separately from FX transactions to fund purchases.

IV. SERVICES TO BE PROVIDED

A. Services to CalSTRS:

1. Accounting Requirements

- a. Provide trade date multi-currency accounting (local and base-U.S. dollars) with full accruals.
- b. Provide accounting services for the following:
 - Domestic and international equities and fixed income portfolios.
 - Multi-plan accounting.
 - Multi-currency securities and cash equivalents.
 - Mortgage loan portfolio.
 - Options and futures.
 - Dividend reinvestment programs.
 - Corporate actions, including but not limited to, mergers, acquisitions, tenders, stock splits, dividends, and spinoffs.
 - Securities lending using multiple vendors with the ability to recall loans prior to record date for purposes of voting proxies.

- c. Provide payable date guarantee for dividends, bond interest (fixed and variable rates) and principal and interest on mortgage pass-through certificates on domestic securities.
- d. Provide payable date guarantee for dividends and bond interest on international securities within the restrictions of the country.
- e. Ability to provide accounting for private equity portfolios.
- f. Accounting must be on a fiscal year basis, July 1 to June 30.
- g. Daily pricing for all publicly traded assets and exchange rates for all currencies.
- h. Provide a secondary pricing source for comparison to the primary source for pricing securities.

2. Settlement Requirements

- a. Provide security clearing (all the major and emerging markets) at all security clearing operations, i.e. Depository Trust Company, Federal Reserve, Euroclear, Cedel, etc.
- b. Ability to settle physically held securities.
- c. Ability to process and settle FX contracts, options, futures, etc..
- d. Fail float protection on all traded securities; credit sales on contractual settlement date and benefit from failed buys, within the restrictions of each country.
- e. Ability to accept electronic trade instructions from CalSTRS managers for all trading activity.
- g. Ability to process corporate action activities.

3. Technology/Systems Requirements

- a. Provide PC-based system or workstation technology with access to management information and accounting data with the capability of providing the following information:
 - current and historical performance
 - current and historical prices and exchange rates
 - ability to create composite portfolios

- current and historical transactions
 - current and historical holdings in any aggregate
 - portfolio aggregate data
 - performance and analytic data bases
 - ability to create customized reports as required
 - ability to create ad hoc reports.
- b. Provide on-line communication and internal accounting links between the Custodian and the State Controller's Office (SCO) for accounting information and claims disbursement processing.
- c. Provide electronic link with specified CalSTRS relationships.
- d. Provide adequate back-up systems to minimize system down-time.
- e. Ability to continue system operations in the event of total shut down of computer systems, i.e., hot site.
- f. Retention of data to be determined by CalSTRS, minimally two (2) years.
4. Report Requirements
- a. Reconcile monthly portfolio holdings and activities with CalSTRS internal and external managers within four (4) business days after month end. Provide audited hard copy accounting reports, including a balance sheet and income statement, to be received on a monthly basis no later than eight (8) business days after month end.
- b. Provide an accurate report of all holdings, transactions and other pertinent investment data, in a format agreed to by both parties no later than 60 days after the end of the fiscal year.
- c. Provide monthly performance reports detailing market performance, portfolio performance, and any aggregate deemed necessary by CalSTRS within thirteen (13) business days after month end. These reports are to include current as well as historical data.
- d. Provide monthly and/or quarterly analytic reports in a format acceptable to CalSTRS.
- e. Performance reports supplied by the proposer must be in compliance with the Association of Investment Management and Research (AIMR).

- f. Ability to electronically transmit holdings, transactions, performance, and analytic data to specified CalSTRS relationships for required monthly or quarterly reporting.
- g. Provide such other reports as may be requested by CalSTRS.

5. Auditing Requirements

- a. Provide audit access to the CalSTRS, SCO, Auditor General, or their designated agents to perform financial and compliance audits or reviews that are deemed necessary.
- b. Maintain an internal audit division that will perform internal control audits which would include systems and risks associated with master trust/custody service.
- c. Engage, with the concurrence of the CalSTRS, an independent audit firm to perform an annual audit specific to the CalSTRS' account on a fiscal year basis (July 1 through June 30).

6. Cash Management

At the direction of CalSTRS, provide short-term investment management services in accordance with the Investment Resolution of the Teachers' Retirement Board (Exhibit 1) and applicable California law.

7. Personnel

At CalSTRS' discretion, proposer must agree to provide a staff member on-site at CalSTRS' site for a period to be determined. The proposed staff must be knowledgeable in the custody and accounting practices of all assets. This person must be well versed in the proposer's technological systems and provide expert advice on day to day activities.

8. Scheduled Meetings

Contractor shall make appropriate personnel available to meet with CalSTRS staff at dates and times determined by CalSTRS, no less than three times a year, or more frequently if required by CalSTRS. The purpose of such meetings will be to discuss Contractor's services related to CalSTRS' needs.

9. Client Servicing

- a. Provide appropriate staff availability to CalSTRS through 4 p.m. Pacific Time.

- b. Ability to provide staff support to money managers located in other time zones.
- c. Provide appropriate staff for periodic meetings with CalSTRS staff and for presentations to CalSTRS staff and Board as requested.

B. Services to State Controller's Office

1. Accounting Requirements

- a. Assure that all transactions submitted to the SCO for receipts and disbursements are complete and accurate.
- b. Provide the capability to download all daily transactions to a PC based system in the Claims Audit Unit at the SCO.
- c. Assure that all transactions contain evidence of proper authorization and control.

2. Internal Control Requirements

- a. Assure that appropriate policies have been established regarding system modifications and that these policies are transmitted to the SCO.
- b. Provide adequate staff and equipment to install and maintain systems, when necessary.
- c. Provide adequate training on any systems installed at the SCO.

3. Oversight Requirements

- a. Provide appropriate documentation supporting all transactions and assure it is available for post-audit review. If such documentation is maintained within an automated system, appropriate retention and back-up policies must be established.
- b. Provide access to the SCO audit and quality assurance review team for the purpose of verifying the integrity of all system operations and data input and output.

C. Services to State Treasurer's Office

Wire all receipts daily to the STO via a designated fiscal agent by 10:00 a.m. PT. (Receipts by the Custodian after 10:00 a.m. PT must be invested in an overnight

collateralized interest bearing account and then wired to the STO by 10:00 a.m. PT the following business day.

V. MINIMUM QUALIFICATIONS AND REQUIREMENTS

The proposers to this RFP must satisfy the minimum qualifications, identified below, to be given further consideration. Failure to satisfy the minimum qualifications will result in the immediate rejection of the proposal.

A. Minimum Qualifications

1. As of December 31, 1999, the proposer must have at least \$50 billion in master trust and custody assets for which it is providing custody and recordkeeping services. The \$50 billion must include domestic and international equity and fixed income assets.
2. As of December 31, 1999, the proposer must have been providing Custody and Recordkeeping Services for clients for a minimum of three (3) years.
3. As of December 31, 1999, the Account Administrator proposed for this engagement must have a minimum of five (5) years experience (three years at the proposing firm) in Custody and Recordkeeping.
4. The transition team leader and the assistant must have worked together on at least one (1) prior multi-billion, multi-manager conversion within the last two years.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
MASTER CUSTODY SERVICES
CONTRACT NO.
FEE SCHEDULES

The proposed fees shall include all costs for providing services to CalSTRS as described in this RFP. Once the Contractor is selected, the fee may be further refined depending on factors which may affect the proposed fee. In no case will the refined fee be higher than the fee contained in this proposal.

I. CONTENT

In completing the following fee schedule, proposers must consider the requirements described in this RFP in Section IV, Services to be Provided. Furthermore, proposers should take into account the following considerations:

- A. The fees are to be proposed in U.S. dollars.
- B. The fee assumes payment will be made in straight "hard dollars". Do not propose alternative sources for payment (i.e. soft dollars or compensating balances).

II. ASSUMPTIONS AND ESTIMATES

- A. The current domestic equity benchmark is the Russell 3000 Index. The passive accounts are invested in the S&P 500 and the Russell Special Small indices. The active portfolios are segmented as follows:
 - Enhanced Index
 - Large Cap Growth, Core and Value
 - Small Cap Growth and Value
- B. The current international benchmark is the MSCI All Country World Index ex-US. The passive accounts are invested in the MSCI EAFE and the Custom Emerging Markets indices. The active portfolios are segmented as follows:
 - Core-EAFE
 - Regional-Pacific Basin and Europe
- C. The current benchmark for the fixed income portfolio is the Salomon Brothers Large Pension Fund Index.
- D. The current benchmark for the Real Estate Equity portfolio is the NCREIF Index.
- E. The current benchmark for the Alternative Investment Portfolio is Russell 3000 Index plus 5%.

- F. A “Summary of Investments Assets” identifying the composition of CalSTRS’ total portfolio as of November 30, 1999 is provided below:

ACTIVE DOMESTIC EQUITIES	\$ 8,291,089,643
PASSIVE DOMESTIC EQUITIES	37,169,750,250
ACTIVE INTERNATIONAL EQUITIES	10,686,792,225
PASSIVE INTERNATIONAL EQUITIES	16,689,217,790
CORPORATE BONDS	7,665,592,147
MORTGAGE BACKED SECURITIES	7,260,397,420
US TREASURIES AND AGENCIES	9,176,864,239
MORTGAGE LOANS	489,446,995
LIQUIDITY	1,225,940,796
REAL ESTATE EQUITIES	2,775,207,962
ALTERNATIVE INVESTMENTS	<u>3,351,833,665</u>
	\$ 104,782,133,132

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
MASTER CUSTODY SERVICES
CONTRACT NO.

FEE SCHEDULE

Name of Proposer

SECTION A - Basic Custody

Please submit your fee for all basic services in a flat monthly amount to cover all services (except as otherwise specified in this schedule) required to be performed in this RFP. The services are to include but are not limited to safekeeping/custody, transaction clearance and settlements, income collections, recordkeeping/accounting, performance and analytics, on-line services, basic and customized reports, etc.

Proposers should consider the following information in calculating the proposed fee. The base portfolio identifies the number of current portfolios.

Base Portfolio:

- 19 Domestic Equity - 16 active portfolios and 3 passive multi-billion dollar portfolios
- 19 International/Regional Equity – 16 active portfolios, 2 passive EAFE portfolios and 1 emerging markets passive portfolio. It is anticipated that CalSTRS will consider inclusion of active emerging markets managers in the future.
- 5 Fixed Income - 3 passive portfolios, 1 mortgage portfolio, and 1 liquidity portfolio. It is anticipated that CalSTRS will consider including high yield bonds to this asset class.
- 10 Real Estate Equity portfolios
- 1 Alternative Investment portfolio

In addition to the above CalSTRS utilizes transition accounts to handle liquidations, transfers or other portfolio structuring tools.

Proposed Monthly fee: \$_____

SECTION B - Adjustment to Basic Custody Fee

Proposers must submit a fee for additions or reductions to the base portfolio identified above for each of the following categories. The fees are to be quoted on a per portfolio basis and must be inclusive of all the required services as stipulated above. The flat fee will be adjusted per the quoted amounts as portfolios are added or deleted.

	<u>Proposed Monthly Adjustment per Portfolio</u>
1. Domestic Equity	\$ _____
2. International/Regional Equity	\$ _____
3. Fixed Income	\$ _____
4. International Fixed Income	\$ _____
5. Real Estate Equity	\$ _____
6. Alternative Investments	\$ _____
7. Miscellaneous	\$ _____

SECTION C - Cash Management

Proposed Monthly Fee: \$ _____

SECTION D - Transition/Conversion

Charges are to include but not be limited to:

- o Equipment
- o Consulting services
- o Notification of payee changes
- o Movement of physical securities
- o Reconciliation
- o Training

Proposed
One-Time
Charge
\$ _____

SECTION E - Securities Lending

	<u>Proposed Percent of Profit</u>	
	<u>Proposer</u>	<u>STRS</u>
Domestic Portfolio:	_____ %	_____ %
International Portfolio:	_____ %	_____ %

Proposer's Authorized Signature

Date

MASTER CUSTODY SERVICES
CONTRACT NO.
WRITTEN PROPOSAL EVALUATION SHEET

<hr style="width: 200px; margin-left: auto; margin-right: auto;"/> Name of Proposer		MAXIMUM POINT <u>SCORE</u>	PROPOSER'S POINT <u>SCORE</u>
A.	QUESTIONNAIRE		
	<u>Section I - Organizational Background</u>	<u>40</u>	
	Organization - Corporate		
	Organization - Business Unit		
	Professional Staff		
	Accounts and Assets		
	Risk Management		
	Commitment to the Business		
	<u>Section II - Services</u>	<u>125</u>	
	Administration and Client Relations		
	Investment Manager Liaison		
	Trade and Foreign Exchange (FX) Processing		
	Settlement and Custody		
	Income and Capital Changes Processing		
	Cash Management		
	Accounting and Reconciliation		
	Reporting		
	Performance Measurement and Analytics		
	Securities Lending		
	<u>Section III - Automation and Communication</u>	<u>50</u>	
	Organization		
	Hardware and Software		
	Systems Development		
	Systems Operations		
	Communications		
	Customized Automation		
	Security		

MAXIMUM
POINT
SCORE

<u>Section IV - Transition and Conversion</u>	<u>35</u>
Planning	
Implementation	
QUESTIONNAIRE TOTAL*	<u>250</u>

* A proposer must receive a minimum score of 175 points on the Questionnaire to be given further consideration

B. FEES	<u>100</u>
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C. FINALIST INTERVIEW	<u>150</u>
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GRAND TOTAL	<u>500</u>
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** A proposer must receive a minimum score of 105 points on the finalist interview to be given further consideration.

CERTIFICATION TO COMPLY WITH
DISABLED VETERAN BUSINESS ENTERPRISE
CONTRACT PARTICIPATION REQUIREMENT

I/We have agree to comply with the Contract Participation Goal requirements. It is understood and agreed that, should our firm be selected as a successful Proposer for this process, the required documentation shall be completed and submitted to STRS to substantiate compliance with the requirements. Documentation shall be submitted prior to the posting of the Notice of Intent to Award, on a date specified by STRS, and shall be subject to STRS' review and approval. We further understand that if this documentation is insufficient and cannot be corrected prior to the date specified by STRS, an agreement cannot be executed..

Proposer's Authorized Signature

Title

Company Name of Proposer

Date

PROPOSED
RESOLUTION
OF THE
TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

Subject: Master Custody Services

Resolution No. _____

WHEREAS, the Board is responsible for managing the Teachers' Retirement Fund (Fund), a Pension Fund; and

WHEREAS, the Board desires to contract with a qualified firm with expertise in providing comprehensive master custody services; and

WHEREAS, the Committee has reviewed the written material and oral presentation from staff; Therefore be it

RESOLVED, that the Committee hereby approves the following:

1. Extension of current contract, to accommodate the timeline for the RFP process;
2. Release of the Request for Proposal as described in Attachment 2;
3. Use of open ended contracts (Evergreen contracts), and ;
4. Delegation of the "Final Selection" to staff periodic updates to the Investment Committee.

Adopted by:

Investment Committee
on January 5, 2000

James D. Mosman
Chief Executive Officer